POWERGEN UK PLC

GROUP REPORT AND ACCOUNTS

for the year ended 31 December 2003

Registered No: 2366970

Directors' report for the year ended 31 December 2003

The directors present their report and the audited accounts of Powergen UK plc ('the Company') and its subsidiaries ('the Group') for the year ended 31 December 2003.

Principal activities, review of business and future developments

The Group's principal activities are electricity generation and distribution, and energy trading and retailing. Powergen's aim is to maintain its position as a leading integrated player in the UK's electricity and gas markets. Powergen's strategy in the UK is to build on this, to sustain and develop its distribution and generation asset businesses and build competitive trading and retail businesses. Both the level of business and financial position of the Group at 31 December 2003 were satisfactory and the Directors believe the present levels of activity in the UK will be sustained in the current year.

On 16 January 2004 Powergen completed the acquisition of the distribution business of Midlands Electricity from Aquila Sterling Holdings LLC for £1,173 million (including net debt acquired and acquisition costs). This effectively doubled the size of Powergen's distribution business, which will be operated as a single business unit under the name Central Networks.

Powergen also acquired a number of other businesses in the transaction. These include an electrical contracting operation and an electricity and gas metering business in the UK as well as minority equity stakes in companies operating three generation plants located in the UK, Turkey and Pakistan. Powergen is currently involved in a process to divest the overseas investments.

In addition, during 2003 Powergen acquired Edenderry Power Limited, which operates a 120 MW peat fired power station plant in the Republic of Ireland for £9 million from Ruhrgas Holdings GmbH, a fellow E.ON group undertaking.

A description of the development of the business during the financial year under report and the outlook for the future is given below. The following section includes information about the Group's research and development ('R&D') activities.

UK Operations

The Group is one of the UK's leading integrated electricity and gas companies with a business built on

- Marketing electricity, gas, telephony and other services to domestic and business customers
- Asset management in electricity production and distribution
- Energy trading to support these activities

Retail

Powergen sells electricity, gas, fixed line telecommunications and other services to three customer segments: residential, business and large industrial customers throughout Britain. At 31 December 2003, Powergen supplied 8.7 million customer accounts, of which 8.6 million were residential and small and medium sized business customer accounts and 0.1 million industrial customer accounts. Powergen continues to focus on reducing the costs of its retail business through improved business efficiencies, better procurement of services and through utilisation of lower cost sales channels.

Residential and small and medium sized business customers

67 per cent of Powergen's residential customer accounts are electricity customers, 31 per cent are gas customers and 2 per cent are fixed line telephone customers. Individual retail customers who buy more than one product (i.e. electricity, gas or fixed line telephone services) are counted as having a separate account for each product, although they may choose to receive a single bill for all Powergen-provided services.

Powergen targets residential and small and medium sized business customers through national marketing activity such as media advertising (including print, television and radio), targeted direct mail, public relations and online campaigns. Powergen also seeks to continue to exploit the high level of national awareness of its brand and has taken steps to enhance the strength of its brand, including the sponsorship of high profile national sports competitions such as the Powergen Cup in both Rugby Union and Rugby League. Powergen is also the main sponsor for Ipswich Town, an English First Division football team.

Powergen announced price rises to its residential customers for gas and electricity in November 2003, which came into effect in January 2004. These price increases were attributable to rising wholesale energy prices seen in the UK marketplace which has also encouraged other energy suppliers to raise prices during 2003. Powergen has delayed the impact of the rises to some of its financially disadvantaged and elderly customers. A further restructuring of prices, including the abolition of standing charges was announced on 1 June 2004, effective from 6 September 2004.

The acquisition of the TXU Group's UK retail business in 2002 more than doubled the size of Powergen's retail business. Powergen has completed the integration of the former TXU operations with its own retail activities and has rebranded the former TXU services under the Powergen brand. The integration process included the re-negotiation of TXU's contract with Vertex, a division of United Utilities plc. This renegotiation secured cost savings in the provision of call related support, billing and collection services to the TXU retail customers.

Industrial & Commercial

In the industrial and commercial sector, Powergen sold 33TWh of electricity and 36 TWh of gas in 2003. The focus of this area of the business remains in retaining and acquiring the most profitable contracts in the market

Generation

Powergen focuses on maintaining a low cost, efficient and flexible electricity generation business in order to compete effectively in the wholesale electricity market. At 31 December 2003, Powergen owned either wholly, or through joint ventures, power stations in the UK with an attributable registered generating capacity of 9,614 MW, including 613 MW of CHP plants and 50 MW of hydroelectric plant. Powergen's attributable portfolio of operational wind capacity stood at 106 MW at the same date.

Powergen's UK plant generated 35.9TWh during 2003, an increase of 6.8 per cent on the 33.6TWh generated in 2002. Powergen's share of the generation market in England and Wales remained relatively stable in 2003 at approximately 11 per cent. The three plants for which control was acquired from TXU in October 2002 did not have a significant impact on Powergen's market share position as two of the three stations were closed in March 2003.

Powergen generates electricity from a diverse portfolio of fuel sources. In 2003, 65 per cent of Powergen's electricity output (excluding CHP) was fuelled by coal and approximately 34 per cent by gas, the remaining 1 per cent being generated from hydroelectric, wind and oil-fired plants. Powergen is continuing its effort to secure a balanced and diverse portfolio of fuel sources, giving it the flexibility to respond to market conditions and to minimise costs.

In October 2002, Powergen announced its intention to mothball the remaining two oil-fired units at Grain and the remaining gas-fired module at Killingholme. One of the Grain units was withdrawn immediately. In March 2003, Powergen closed High Marnham and Drakelow C, two old and inefficient coal stations for which control was acquired from TXU, and mothballed the remaining modules at Killingholme and Grain. By December 2003, two oil-fired units at Grain had been returned to service following the recovery of wholesale power prices during the latter half of the year, while both modules at Killingholme were operating in limited open cycle mode (600MW) under a standing reserve contract with National Grid Transco plc. Powergen regularly monitors the economic status of its operational and mothballed plant and will react to future movements in the market accordingly.

Renewable Energy

Powergen plans to grow its renewable generation business in response to recent UK government and regulatory initiatives. Since 1999, Powergen's wind generation projects have been developed by Powergen Renewables Limited, which was initially a joint venture with Abbot Group plc ("Abbot"). Given the importance of renewable generation growth in Powergen's overall strategy, Powergen bought out Abbot's share in the joint venture in October 2002. Powergen is already one of the UK's leading developers and owner/operators of wind farms, with interests in 15 operational onshore and offshore wind farms in the UK and Ireland with total capacity of 118 MW, of which 106 MW is attributable to Powergen. As a part of its balanced approach, Powergen seeks to fulfil its renewables obligation through a combination of its own generation and renewable energy purchased from other tradable Renewable Obligation Certificate ('ROC') generators under contract and direct payment of any residual obligation into the buyout fund. During the period April 2002 to March 2003, Powergen achieved its 3% renewable obligation.

During 2003, Powergen began construction of a large major offshore wind farm at Scroby Sands (60MW) building on the success of completing the UK's first offshore wind farm at Blyth during 2001. Further onshore wind projects totalling 16 MW are currently under construction and 755 MW of wind schemes are in the development phase. Powergen's development strategy is now focused on larger capacity (greater than 15MW) schemes rather than small-scale wind and hydro projects in order to maximise the renewables capacity and optimize development focus. In addition to the wind portfolio Powergen is evaluating dedicated biomass developments and has obtained permission from the Environment Agency to co-fire biomass materials at Kingsnorth, Ironbridge and Ratcliffe power stations which in total generated 39 GWh of renewables output during 2003.

CHP

Powergen also operates large-scale combined heat and power (CHP) schemes. CHP is an energy efficient technology which recovers heat from the power generation process and uses it for industrial processes such as steam generation, product drying, fermentation, sterilizing or heating. Powergen's total operational CHP electricity capacity is 613 MW with clients ranging across a number of sectors, including pharmaceuticals, chemicals, paper and oil-refining. One project with a total capacity of 30 MW is in the final stage of commissioning.

Distribution

Central Networks East plc (formerly East Midlands Electricity Distribution plc and henceforth referred to as 'EME') and the newly-acquired Midlands Electricity plc, both wholly owned subsidiaries of Powergen UK plc, own, manage and operate two electricity distribution networks servicing the East and West Midlands areas of England, respectively. The combined service areas cover approximately 11,200 square miles, extending from the Welsh border in the West to the Lincolnshire coast in the East and from Chesterfield in the North to the northern outskirts of Bristol in the South and containing a resident population of approximately 10 million people. The networks distribute electricity to approximately 4.8 million homes and businesses in the combined service areas, and virtually all electricity supplied to consumers in the service areas (whether Powergen's retail business or by other suppliers) is transported through the EME or Midlands Electricity distribution network**.**

Powergen has initiated an integration process for the EME and Midlands Electricity distribution businesses which it expects to result in more efficient operations as well as cost savings. Powergen intends to manage the two distribution networks in a single business, to be called "Central Networks." This combined business will be managed by a centralised management team at Powergen but will maintain the current, separate distribution licences.

The Electricity Price Control Review (DR4) has commenced and will run throughout 2004. The Price Control Review will set the allowed revenue, allowed capital and performance targets for the distribution businesses for five years from April 2005. Powergen is expecting final proposals from Ofgem in November 2004 to be effective from 1 April 2005.

Energy Trading

Energy Trading is at the centre of Powergen's integrated electricity and gas business in the UK. It engages in asset-based energy marketing in gas and electricity markets to assist in the commercial risk management and optimisation of both UK electricity and gas assets and to manage the price and volume risks associated with the UK retail business. The business also co-ordinates market actions within the UK business and seeks to maximise the value from generation and customer assets. Powergen's plant portfolio is strictly monitored and controlled to ensure that changing levels of exposure are appropriately managed.

Powergen also engages in a controlled amount of proprietary trading in gas, power, coal and oil markets in order to take advantage of market opportunities and maintain the highest levels of market understanding required to support optimization and risk management activities. In 2003, proprietary trading gross volumes totalled 40.4TWh in power (2002: 45.6TWh) and 10.5 billion therms of gas (2002: 10.1 billion therms)

Other activities

The UK Services business provides a single shared service function delivering IT, facilities management, HR, procurement, insurance, property and finance support for all of Powergen's UK operations.

Powergen's engineering and scientific development activities, carried out at its Powertechnology Centre, are focused on supporting the Company's strategic business objectives and technology challenges in the UK and US through delivery of R&D programmes, providing innovative services and products and growing profitable new income streams.

Asian Asset Management

In 2003, Powergen continued divestment of its Asian asset management business, which consisted of joint venture equity and operating interests in independent power production ("IPP") activities in India, Australia and Indonesia. By 31 December 2003, Powergen had completed the sale of its interests in operating plants in India and Australia, together with a development project in Thailand to CLP Power International. It had also concluded a bidding process for the sale of its only remaining Asian interest being a 35 percent of PT Jawa Power, owner of a 1,220 MW plant at Paiton in Indonesia, and 100 per cent of the associated operating and maintenance company. The sale of this interest is expected to complete before the end of 2004.

Results and dividends

The profit attributable to shareholders for the financial year to 31 December 2003 was £189 million (compared with a profit of £516 million for the year ended 31 December 2002).

The directors do not recommend payment of a final dividend (year ended 31 December 2002 £nil). During the year, no interim dividends were paid (year ended 31 December 2002 £64 million).

Directors and their interests

The following directors served on the Board during the year and subsequent to the year end:

	Date of appointment*	Date of resignation
Dr Paul Golby		
Graham Bartlett		
Dr Wulf Bernotat	01/04/2004	
Anthony Cocker	01/04/2004	
Nicholas Horler	01/04/2004	
Jarri Sandstrom	01/04/2004	
Robert Taylor	01/04/2004	
Michael Söhlke		31/12/2003
Powergen Directors Limited		31/12/2003

* If during the year or subsequent to the year end

Information on directors' emoluments is given in Note 4 to the Accounts, on pages 32 and 33.

No director had, at any time during the period under report, any interest in the shares of the Company or any subsidiary undertaking. At 31 December 2003 and 31 December 2002 no director had any interest requiring disclosure in these accounts.

Employees

The Company provides an environment in which communication is open and constructive. There are well-established arrangements for communication and consultation with employees and their representatives at local and Company level which covers a wide range of business and employment issues including those considered by the E.ON European Works Council, which provides a forum for consultation on major issues affecting E.ON Group companies in Europe.

The Group is committed to offering equal opportunities to both current and prospective employees. The Group continues to review and develop best practices and procedures to ensure that all staff are treated fairly in all aspects of employment. It also strives for a diverse environment that is supportive of all staff. Individual differences which do not relate to job performance such as gender, marital status, sexual orientation, race, colour, ethnic origin, nationality, religion, age or disability are respected.

The Group believes in ensuring that disabled people can compete fairly for job opportunities, training and development, through the promotion and development of best practices. Links and contacts with external disability networks and organisations are maintained to identify best practices in the employment of people with disabilities and to provide work experience placements for disabled people. In the event of existing employees becoming disabled, the Group will seek to maintain their employment through training, redeployment and adjustments to the job role and workplace, where it is reasonable and practicable to do so.

Training and development of staff remains a key priority in achieving the UK growth strategy and ensuring that all staff perform at the highest level.

Contributions for political and charitable purposes

Donations to charitable organisations during the financial year by the Company and its subsidiaries amounted to £41,418. The decrease from the prior year value of £150,872 is due to the timing of payments as opposed to a reduction in donation values. No political donations were made.

Policy on payment of creditors

Where appropriate in relation to specific contracts, the Group's practice is to:

a) settle the terms of payment with the supplier when agreeing the terms of each transaction;
b) ensure that those suppliers are made aware of the terms of payment by inclusion of relevant terms in the contracts; and
c) pay in accordance with its contractual and other legal obligations.

The Group supports the Better Payments Practice Code, and has in place well developed arrangements with a view to ensuring that this is observed in all other cases. Group companies operating overseas are encouraged to adopt equivalent arrangements by applying local best practices. The average number of days taken to pay the Group's trade suppliers calculated in accordance with the requirements of the Companies Act is 45 days (31 December 2002 29 days).

Introduction of the Euro

The Group recognises the wide implications of the Euro for businesses, including impacts on commercial arrangements and financial systems. Within the UK, the Group's preparations recognise the uncertain position regarding possible UK entry to the single currency, and the situation is monitored closely.

Going Concern

The Board has reviewed the Group's budget and cash flow forecasts for the year ended 31 December 2004 and the outline projections for the two subsequent years. The directors confirm that they have a reasonable expectation that the Company and the Group have adequate resources to continue in operational existence for the foreseeable future. Accordingly, the directors continue to adopt the going concern basis in preparing the Company's consolidated financial statements.

Directors' responsibilities

Company law requires the directors to prepare financial statements for each financial year that give a true and fair view of the state of affairs of the Company and of the Group and of the profit or loss of the Group for that year. In preparing those financial statements, the directors are required to:

- select suitable accounting policies and then apply them consistently;
- make judgements and estimates that are reasonable and prudent;
- state whether applicable accounting standards have been followed, subject to any material departure disclosed and explained in the financial statements; and
- prepare the financial statements on the going concern basis, unless it is inappropriate to presume that the company will continue in business.

The directors are responsible for keeping proper accounting records that disclose with reasonable accuracy at any time the financial position of the Company and Group and enable them to ensure that the financial statements comply with the Companies Act 1985. They are also responsible for safeguarding the assets of the Company and Group and hence for taking reasonable steps for the prevention and detection of fraud and other irregularities. The directors believe that they have fulfilled their responsibilities.

Auditors

A resolution to reappoint the auditors, PricewaterhouseCoopers LLP, and to authorise the directors to fix their remuneration will be proposed at the forthcoming Annual General Meeting.

By order of the Board

Fiona Stark
Company Secretary
Powergen UK plc
Westwood Way
Westwood Business Park
Coventry
CV4 8LG
23 June 2004

Financial review for the year ended 31 December 2003

This review is designed to give further financial information concerning the Powergen Group results for the year.

Overview

2003 was a year of consolidation for the Group following the completion of the acquisition of the Powergen Group by E.ON AG on 1 July 2002 and the acquisition of the TXU retail business on 21 October 2002 which has enabled Powergen to become the UK's largest retail electricity supplier and the second largest in the whole retail energy sector. During 2003 the TXU business has been fully integrated into the existing UK structure.

Accounting Policies

There have been no significant changes in accounting policies during the year.

Group financial results

Profit before tax and exceptional items for the year ended 31 December 2003 was £348 million, compared to £154 million for the same period last year. The profit before tax was £233 million compared with £494 million for the previous twelve months.

Turnover

Group turnover grew by £2,072 million during the year to £6,772 million, an increase of 44 per cent. Turnover in the UK primarily increased due to the inclusion of a full year's trading from the ex-TXU retail business which was acquired in October 2002. There was no Group turnover during 2003 in Asian Asset Management following the sale of the controlling stake in GPEC (India) during February 2002.

Turnover is further analysed below:

	Year ended 31 December 2003 £m	Year ended 31 December 2002 £m
UK Operations		
Electricity and gas – wholesale and trading	**2,282**	2,104
Electricity – distribution	**303**	289
Electricity and gas – retail	**4,324**	2,417
Internal charges from distribution to retail	**(137)**	(125)
	6,772	4,685
Asian Asset Management	**-**	15
	6,772	4,700

Operating Costs

Details of the Group's operating costs are set out in note 2 to the financial statements. The figures are summarised below.

	Year ended 31 December 2003 £m	Year ended 31 December 2002 £m
Fuel costs	**369**	366
Power purchases and other costs of sales	**5,041**	3,313
Staff costs	**225**	203
Depreciation	**162**	167
Goodwill amortisation	**181**	90
Other operating charges, including restructuring costs	**640**	497
	6,618	4,636

Total fuel costs within the Group were similar year on year. Power purchases and other costs of sales continued to include the cost of electricity purchased to meet customer sales obligations, charges from the National Grid Transco Group and Regional Electricity Companies for the use of their transmission and distribution systems, and costs of the gas trading and retail businesses. The increase of £1,728 million in costs during the year again primarily reflected the inclusion of a full years power purchases and other costs from the ex-TXU retail business.

Staff costs at £225 million were 11 per cent higher than in the previous year due to the acquisition of 1,900 staff with the TXU business in October 2002. Staff numbers at 31 December 2003 totalled 6,559 of whom 6,188 were in the UK and 371 in Asian Asset Management and the Corporate Centre.

Goodwill amortisation rose from £90 million in 2002 to £181 million in 2003. The increase was primarily due to the acquisition of TXU.

Other operating charges included the costs of running the UK, and Asian Asset Management businesses and the supporting corporate infrastructure. Major business costs included maintenance and overhaul costs at power stations, business rates and insurance costs. The 2003 figure of £640 million includes £123 million of exceptional costs relating to business restructuring in the UK following the integration of TXU into Powergen.

Operating income

Other operating income was £112 million this year compared with £111 million in the year to 31 December 2002. The 2003 figure includes £100 million of deferred warranty income as part of the disposal arrangements for Fiddler's Ferry and Ferrybridge C power stations in July 1999. The warranty income is recognised as Powergen agreed to provide services associated with a major parts warranty in respect of future operations, capability and maintenance of each station. The comparable figure in 2002 was also £100 million.

Financial review for the year ended 31 December 2003 (continued)

Exceptional items

The Group's results include a number of exceptional items totalling a £115 million charge (year ended 31 December 2002 £340 million credit) that are disclosed in note 3 to the financial statements. These exceptionals fell into two main categories:

- UK business integration costs
- International and UK business disposals and write downs

Operating profits

A more detailed analysis of operating profits and reconciliation to profit before tax, is set out below:

	Year ended 31 December 2003 £m	Year ended 31 December 2002 £m
UK Operations		
Electricity and gas – wholesale and trading	**(19)**	91
Electricity – distribution	**155**	129
Electricity and gas – retail	**421**	105
Lease and other income and charges	**26**	83
	583	408
Asian Asset Management	**58**	65
Intra-group foreign exchange differences	**9**	(73)
Goodwill amortisation	**(181)**	(90)
Corporate costs	**(13)**	(12)
Operating profit before exceptional items	**456**	298
Interest costs	**(108)**	(144)
Profit before exceptional items	**348**	154
Exceptional items	**(115)**	340
Profit before tax	**233**	494

Operating profits including share of associates and joint ventures, but excluding exceptional items, totalled £456 million for the year compared with £298 million in the same period to 31 December 2002.

Within UK Operations, operating profits increased by £175 million to £583 million. Within this total, wholesale and trading profits fell by £110 million to a £19 million loss, largely due to the impact of higher wholesale purchase costs and higher balancing mechanism participation charges.

The distribution business saw profits increase by £26 million to £155 million. This was due to higher allowed regulatory income together with cost savings reflecting the continuing benefits of a four year cost saving programme completed in 2002.

Within the retail business, profits increased by £316 million to £421 million. This was largely due to profits from the ex-TXU business acquired on 21 October 2002.

There was also a £57 million reduction in lease and other income and charges, largely due to lower central provisioning requirements in the acquisition of the TXU retail business in October 2002, and a full year cost of central TXU activities absorbed into the combined Powergen business.

Profits from Asian Asset Management totalled £58 million, compared with £65 million in the year to 31 December 2002. Results for the year were split between Paiton, together with its operating and maintenance company, contributing £59 million (2002 £57 million) less central costs and overheads of £1 million (2002 £6 million). The 2002 results also included £14 million from GPEC prior to the sale of the controlling interest.

Interest costs

Interest costs comprise group interest costs and interest costs for associates and joint ventures. The latter fell slightly from £30 million to £24 million for the year ended 31 December 2003. Group interest costs fell by £30 million from £114 million to £84 million this reflected the lower interest rates in the UK, and cheaper financing from within the E.ON Group.

Treasury management

Following the integration of Powergen into the E.ON Group all treasury policies are set centrally by E.ON AG. Powergen, in common with other major E.ON subsidiaries, must comply with E.ON financial management and treasury policies and procedures but must also have its own local operational treasury team which services the treasury requirements of the business. The teams liaise closely with the local business to ensure that liquidity and risk management needs are met within the requirements of the E.ON policies and procedures. The treasury team works closely with the treasury and corporate finance teams at E.ON AG.

E.ON has a central department that is responsible for financing and treasury strategy, policies and procedure throughout the E.ON Group. Major strategic financings and corporate finance actions are planned and executed by the corporate finance team at E.ON. There is also a treasury team which co-ordinates currency and interest risk management as well as cash management for the whole E.ON Group.

Powergen also operates its own specific treasury procedures within the overall E.ON treasury framework.

E.ON's central financing strategy

E.ON's financing policy is to centralise external financing at the E.ON AG holding company level, and to reduce external debt in subsidiaries wherever possible. E.ON AG has the strongest credit rating in the E.ON Group, and this allows the finest terms for external finance to be negotiated. E.ON AG then funds its subsidiaries with inter-company finance. This finance may be in the form of equity or debt, as appropriate.

The Powergen UK treasury team employs a continuous forecasting and monitoring process to ensure that the Group complies with all its banking and other financial covenants, and also the regulatory constraints that apply to the financing of the UK business. Powergen Treasury works in close liaison with the various operating businesses within the Group, when considering hedging requirements on behalf of their activities. A group-wide cash forecasting and currency exposure reporting process exists which ensures regular reporting into treasury of future positions, both short and medium term. Information is submitted to E.ON for incorporation into E.ON Group forecasting processes on a monthly and quarterly basis

Powergen does not enter into speculative treasury arrangements. Accordingly, all transactions in financial instruments are matched to an underlying business requirement, such as planned purchases or forecast debt requirements. Treasury activities are reviewed by internal audit on an annual basis.

The year end position described in more detail below is representative of the Group's current position in terms of its objectives, policies and strategies. These will continue to evolve as the Group's business develops, in line with the requirements, objectives, policies and strategies of E.ON as the parent company of the Group.

Foreign exchange risk management

Powergen's principal currency exposure is to the US dollar. Powergen operates within the framework of E.ON's guidelines for foreign exchange risk management. Powergen has local Board approved policies dealing with transaction exposures (typically trading cash flows which impact the profit and loss account) and translation exposures (the value of foreign currency liabilities and assets in the balance sheet). Powergen's policy is to hedge all contractually committed transaction exposures, as soon as the commitment arises. Powergen also covers a proportion of forecast foreign currency cash flows, and will also hedge more uncertain cash flows if this is appropriate, using flexible financial instruments that do not commit the Group.

Powergen's policy towards translation exposures is to hedge these exposures where practicable, with the intention of protecting the Sterling net asset value. These hedges are normally achieved through a combination of borrowing in local currency, forward currency contracts or foreign currency swaps.

Where the foreign currency transaction exposure is hedged, the value of the exposure is translated into Sterling at the exchange rate achieved in the associated hedging contracts. Details of the Group's foreign exchange contracts and swaps are set out in note 28 to the accounts.

Interest rate risk management

Powergen operates within the E.ON framework for interest rate risk management. E.ON requires subsidiaries to maintain a fixed and floating ratio between 20 per cent and 80 per cent. The Group has a significant portfolio of debt, and is exposed to movements in interest rates. This exposure is to both Sterling and US Dollar interest rates, and Powergen manages these interest rate movements primarily through the use of fixed and floating rate borrowings and interest rate swaps.

Off balance sheet finance

Powergen has minority equity interests in certain joint ventures that are principally financed by debt. In each case the joint venture debt is secured against the assets of the project and has no, or very limited, recourse back to Powergen. Powergen also has small operating lease financings typical for a company of its size.

Liquidity planning, trends and risks

The acquisition of Powergen by E.ON has significantly improved availability of liquidity to Powergen. Powergen has sufficient committed borrowing facilities, through E.ON Group resources, to meet planned liquidity needs, including facilities provided by its parent company E.ON at a lower cost than Powergen could achieve externally. Movements in electricity prices have some impact on operating cash flows, and as electricity generation and distribution is a capital intensive business, planned capital spending remains at significant levels. The level of operating cash is affected by the performance of the business, and market prices and margins amongst other things. Some of these factors are outside the Company's control.

Most of Powergen's capital market bond financings do not have financial covenants, but a fall in the credit rating below investment grade could, in some circumstances, require repayment of these bonds.

Credit rating

Following the E.ON acquisition, Powergen’s credit rating was upgraded to A by Standard and Poor’s and to A2 by Moody’s. However, following the acquisition of TXU by Powergen in October 2002, Powergen’s credit rating was downgraded to A- by Standard and Poor’s and A3 by Moody’s.

Borrowings and facilities

Details of the bank term facilities available to the Group at 31 December 2003, including the amounts undrawn on the facilities, and their expiry dates are fully set out in note 19 to the accounts. This note also sets out details of the Group’s long-term and short-term bonds raised on UK and US capital markets.

At 31 December 2003, the Group had total borrowings of £2,396 million (31 December 2002 £1,834 million) including £1,079 million of long-term loans and £1,317 million of short-term loans and overdrafts.

At 31 December 2003, the Group had £41 million of cash and short-term investments (31 December 2002 £93 million). Powergen's policy is to place any surplus funds on short-term deposit with approved banks and financial institutions. Strict limits governing the maximum exposure to these banks and financial institutions are applied. These limits are co-ordinated across the E.ON Group.

The Group's net borrowing position at 31 December 2003 was therefore £2,355 million, compared to £1,741 million at 31 December 2002. The average interest rate for the year, when compared to average net borrowings, was 3.7 per cent compared with 5.5 per cent in the previous year. This fall is attributable to lower interest rates from the E.ON group.

Gearing (net debt as a percentage of net assets plus net debt) was 49 per cent at 31 December 2003 compared with 43 per cent at the end of 2002.

Commodity risk management

As part of its operating activities, Powergen engages in asset based energy marketing in the gas, electricity, coal and oil markets. This activity is primarily focused around the commercial risk management and optimisation of both UK electricity and gas assets and to manage the price and volume risks associated with its UK retail business, but also encompasses limited proprietary trading in the UK and some European energy markets.

All of Powergen's energy trading operations are subject to Powergen and E.ON's risk management policies. These include value and profit at risk, credit limits, segregation of duties and an independent risk reporting system. To achieve its portfolio optimisation Powergen uses fixed price bilateral contracts, futures and option contracts traded on commodity exchanges and swaps and options traded in over-the-counter financial markets.

Taxation

The pre-exceptional tax charge amounted to £54 million for the year compared with £61 million for the same period to 31 December 2002. The effective rate before exceptional items was 16 per cent compared with 40 per cent in the year to 31 December 2002. The main reasons for the decrease in the effective rate were the change in the impact of discounting the deferred tax provision under FRS 19 and adjustment to the current and deferred tax provisions in respect of prior year items.

Dividends

No dividends were paid or payable during the year ended 31 December 2003.

Independent auditors' report to the members of Powergen UK plc

We have audited the financial statements which comprise the profit and loss account, the group and company balance sheets, the statement of group total recognised gains and losses, the principal accounting policies and the related notes.

Respective responsibilities of directors and auditors

The directors' responsibilities for preparing the annual report and the financial statements in accordance with applicable United Kingdom law and Accounting Standards are set out in the statement of directors' responsibilities.

Our responsibility is to audit the financial statements in accordance with relevant legal and regulatory requirements and United Kingdom Auditing Standards issued by the Auditing Practices Board. This report, including the opinion has been prepared for and only for the Company's members as a body in accordance with Section 235 of the Companies Act 1985 and for no other purpose. We do not, in giving this opinion, accept or assume responsibility for any other purpose or to any other person to whom this report is shown or in to whose hands it may come save where expressly agreed by our prior consent in writing.

We report to you our opinion as to whether the financial statements give a true and fair view and are properly prepared in accordance with the Companies Act 1985. We also report to you if, in our opinion, the directors' report and the financial review are not consistent with the financial statements, if the Company has not kept proper accounting records, if we have not received all the information and explanations we require for our audit, or if information specified by law regarding directors' remuneration and transactions is not disclosed.

We read the other information contained in the annual report and consider the implications for our report if we become aware of any apparent misstatements or material inconsistencies with the financial statements. The other information comprises only the directors' report.

Basis of audit opinion

We conducted our audit in accordance with Auditing Standards issued by the Auditing Practices Board. An audit includes examination, on a test basis, of evidence relevant to the amounts and disclosures in the financial statements. It also includes an assessment of the significant estimates and judgements made by the directors in the preparation of the financial statements, and of whether the accounting policies are appropriate to the Company's circumstances, consistently applied and adequately disclosed.

Independent auditors' report to the members of Powergen UK plc (continued)

We planned and performed our audit so as to obtain all the information and explanations which we considered necessary in order to provide us with sufficient evidence to give reasonable assurance that the financial statements are free from material misstatement, whether caused by fraud or other irregularity or error. In forming our opinion we also evaluated the overall adequacy of the presentation of information in the financial statements.

Opinion

In our opinion the financial statements give a true and fair view of the state of affairs of the Company and the Group at 31 December 2003 and of the profit of the Group for the year then ended and have been properly prepared in accordance with the Companies Act 1985.

PricewaterhouseCoopers LLP
Chartered Accountants and Registered Auditors
Birmingham
23 June 2004

CONSOLIDATED PROFIT AND LOSS ACCOUNT
for the year ended 31 December 2003

	Note	Year ended 31 December 2003			Year ended 31 December 2002		
		Before exceptional items £m	**Exceptional items (note 3) £m**	**Total £m**	Before exceptional items £m	Exceptional items (note 3) £m	Total £m
Turnover		**6,915**	**-**	**6,915**	4,919	-	4,919
Group's share of associates' and joint ventures' turnover		**(143)**	**-**	**(143)**	(219)	-	(219)
Group turnover – continuing activities	1	**6,772**	**-**	**6,772**	4,700	-	4,700
Operating costs	2,3	**(6,495)**	**(123)**	**(6,618)**	(4,588)	(48)	(4,636)
Other operating income	2	**112**	**-**	**112**	111	-	111
Group operating profit/(loss) – continuing activities	2	**389**	**(123)**	**266**	223	(48)	175
Group's share of associates' and joint ventures' operating profit	6	**67**	**-**	**67**	75	-	75
Profits less losses on disposal of businesses (including provisions)	3	**-**	**8**	**8**	-	388	388
Net interest payable							
– group	5	**(84)**	**-**	**(84)**	(114)	-	(114)
– associates and joint ventures		**(24)**	**-**	**(24)**	(30)	-	(30)
Profit/(Loss) on ordinary activities before taxation	6	**348**	**(115)**	**233**	154	340	494
Tax on profit/(loss)on ordinary activities	7	**(54)**	**10**	**(44)**	(61)	84	23
Profit/(Loss) on ordinary activities after taxation		**294**	**(105)**	**189**	93	424	517
Minority interest	26	**-**	**-**	**-**	(1)	-	(1)
Profit/(Loss) attributable to shareholders		**294**	**(105)**	**189**	92	424	516
Dividends	8			**-**			(64)
Retained profit for the year	**25**			**189**			452

STATEMENT OF GROUP TOTAL RECOGNISED GAINS AND LOSSES
for the year ended 31 December 2003

	Year ended 31 December 2003 £m	Year ended 31 December 2002 £m
Profit attributable to shareholders	**189**	516
Revaluation of fixed assets and investments on acquisitions	**-**	16
Currency translation differences on foreign currency net investments	**(5)**	(13)
Total recognised gains for the year	**184**	519

The accounting policies and the notes on pages 21 to 60 form part of these financial statements**.**

POWERGEN UK PLC

BALANCE SHEETS
as at 31 December 2003

	Note	The Group 31 December 2003 £m	31 December 2002 £m	The Company 31 December 2003 £m	31 December 2002 £m
Fixed assets					
Goodwill	11	**2,673**	2,808	**30**	32
Tangible assets	12	**2,562**	2,474	**954**	990
Investments	13	**191**	253	**2,950**	2,560
		5,426	5,535	**3,934**	3,582
Current assets					
Stocks	14	**90**	110	**80**	103
Debtors: amounts falling due after more than one year	15	**10**	17	**10**	3
Debtors: amounts falling due within one year	16	**1,234**	2,999	**1,968**	5,312
Cash and short-term deposits		**41**	93	**13**	55
		1,375	3,219	**2,071**	5,473
Creditors: amounts falling due within one year					
Loans and overdrafts	17	**(1,317)**	(753)	**(254)**	(803)
Trade and other creditors	18	**(1,393)**	(3,979)	**(2,479)**	(4,826)
Net current liabilities		**(1,335)**	(1,513)	**(662)**	(156)
Total assets less current liabilities		**4,091**	4,022	**3,272**	3,426
Creditors: amounts falling due after more than one year					
Long-term loans	19	**(1,079)**	(1,081)	**(821)**	(821)
Other creditors	20	**(129)**	(156)	**(405)**	(435)
Provisions for liabilities and charges	22	**(211)**	(343)	**(83)**	(82)
Deferred tax	23	**(218)**	(172)	**(101)**	(120)
Net assets		**2,454**	2,270	**1,862**	1,968
Capital and reserves					
Called-up share capital	24	**325**	325	**325**	325
Share premium account	25	**97**	97	**97**	97
Capital reserve	25	**474**	474	**474**	474
Revaluation reserve	25	**15**	16	**-**	-
Capital redemption reserve	25	**85**	85	**85**	85
Profit and loss account	25	**1,454**	1,269	**881**	987
Equity shareholders' funds	27	**2,450**	2,266	**1,862**	1,968
Equity minority interests	26	**4**	4	**-**	-
		2,454	2,270	**1,862**	1,968

Approved by the Board on 23 June 2004

Graham Bartlett
Director

The accounting policies and the notes on pages 21 to 60 form part of these financial statements

Principal Accounting Policies

Nature of operations

The Group has two main businesses; UK Operations and Asian Asset Management. The principal business in the UK is the generation, distribution and sale of electricity and the sale of gas. The principal business overseas is the generation of electricity and associated energy-related businesses.

Basis of preparation of accounts

The financial statements are prepared under the historical cost convention and in accordance with applicable United Kingdom accounting standards and the Companies Act 1985 except for the accounting policies for commodity instruments (see financial instruments below) and customer contributions (see tangible fixed assets below) and accounting for subsidiaries which were previously accounted for as associated undertakings where the true and fair over-ride has been used as required by Financial Reporting Standard 2 'Accounting for Subsidiary Undertakings' has been used. There have been no changes in accounting policies during the year.

There is no difference between the profit on ordinary activities before taxation and the retained profit for the year stated on the face of the consolidated profit and loss account and their historical cost equivalents. Values of assets and liabilities vested in the Company on 31 March 1990 under the Transfer Scheme made pursuant to the Electricity Act 1989 (the Transfer Scheme) are based on their historical cost to the Central Electricity Generating Board (CEGB).

The preparation of financial statements in conformity with generally accepted accounting principles requires management to make estimates and assumptions which affect the reported amounts of assets and liabilities, the disclosure of contingent assets and liabilities at the date of the financial statements, and the reported amounts of revenues and expenses during the reporting year. Actual results can differ from those estimates.

Basis of consolidation

The consolidated accounts include the financial statements of the Company and all of its subsidiary undertakings, together with the Group's share of the results and net assets of associated undertakings and joint ventures. The results of subsidiaries sold or acquired are included in the consolidated profit and loss account up to, or from, the date on which control passes. Intra-group sales, profits, and balances are eliminated on consolidation.

Principal Accounting Policies (continued)

Associated undertakings and joint ventures

The Group's share of profits less losses of associated undertakings and joint ventures is included in the consolidated profit and loss account. The results of associates and joint ventures sold or acquired are included in the consolidated profit and loss account up to, or from, the date on which significant influence passes. These amounts are taken from the latest audited financial statements of the relevant undertakings, except where the accounting reference date of the undertaking is not coterminous with the parent company, where management accounts are used.

The accounting reference dates of associated undertakings and joint ventures are set out in note 13. Where the accounting policies of associated undertakings and joint ventures do not conform to those of the Group, adjustments are made on consolidation where the amounts involved are material to the Group.

Turnover

Turnover within the United Kingdom comprises wholesale of electricity; revenue from the sale of electricity and gas to industrial and commercial customers; sales of electricity, gas and telephony services to domestic customers; revenue from the distribution of electricity and the sale of electricity and steam under combined heat and power schemes. Turnover excludes Value Added Tax.

Income from the sale of electricity and gas to industrial, commercial and domestic customers is recognised when earned and reflects the value of units supplied, including an estimated value of units supplied to customers between the date of their last meter reading and the year end.

Restructuring costs

Amounts are set aside for the Group's restructuring programme that involves the reorganisation or future closure of power station and other sites and specific reductions in staff numbers, where the Group is demonstrably committed to such actions.

Depreciation

Provision for depreciation of generating and other assets is made so as to write off, on a straight-line basis, the book value of tangible fixed assets. Assets are depreciated over their estimated useful lives or, in the case of leased assets, over the lease term if shorter. Estimated useful lives are reviewed periodically. No depreciation is provided on freehold land or assets in the course of construction.

The estimated useful lives for the other principal categories of fixed assets are:

Asset	*Life in years*
Generating assets	25-45
Distribution and transmission networks	40-60
Other assets	3-40

Principal Accounting Policies (continued)

Overhaul of generation plant

Overhaul costs are capitalised as part of generating assets and depreciated on a straight-line basis over their estimated useful life, typically the period until the next major overhaul. That period is usually four years.

Decommissioning

A fixed asset and related provision is recognised in respect of the estimated total discounted cost of decommissioning generating assets. The resulting fixed asset is depreciated on a straight-line basis, and the discount on the provision is amortised, over the useful life of the associated power stations.

Foreign exchange

Assets and liabilities expressed in foreign currencies, including those of subsidiaries, associated undertakings and joint ventures are translated to Sterling at rates of exchange ruling at the end of the financial year. The results of foreign subsidiaries, associated undertakings and joint ventures are translated to Sterling using average exchange rates.

Transactions denominated in foreign currencies are translated to Sterling at the exchange rate ruling on the date payment takes place unless related or matching forward foreign exchange contracts have been entered into when the rate specified in the contract is used. Differences on exchange arising from the re-translation of the opening net investment in, and results of, subsidiaries, associated undertakings and joint ventures are taken to reserves and, where the net investments are hedged, are matched with differences arising on the translation of related foreign currency borrowings and forward exchange contracts. Any differences arising are reported in the statement of total recognised gains and losses. All other realised foreign exchange differences are taken to the profit and loss account in the year in which they arise.

Deferred income

Amounts received in advance in respect of the provision of services under warranty arrangements are taken to deferred income and recognised in operating income over the period to which the warranty cover relates. Costs associated with the provision of services under the warranty arrangements are netted against the operating income, and are recognised when incurred.

Principal Accounting Policies (continued)

Financial instruments

The Group uses a range of derivative instruments, including interest rate swaps, cross-currency swaps and energy-based options and futures contracts and foreign exchange contracts and swaps. Derivative instruments are used for hedging purposes, apart from energy-based options and futures contracts, which are used for trading purposes. The accounting policy for each instrument is set out below. Interest differentials on derivative instruments are charged to the profit and loss account as interest costs in the period to which they relate. Accounting for foreign currency transactions is described in the foreign exchange policy set out above. Changes in the market value of options and futures trading contracts are reflected in the profit and loss account in the period in which the change occurs.

Debt instruments

Following the issue of Financial Reporting Standard 4 ‘Capital Instruments’ (FRS4) all borrowings are initially stated at the fair value of consideration received after deduction of issue costs. The issue costs and interest payable on bonds are charged to the profit and loss account at a constant rate over the life of the bond. Any premium or discount arising on the early repayment of borrowings is written off to the profit and loss account as incurred.

Interest rate swaps

Interest rate swap agreements are used to manage interest rate exposures. Amounts payable or receivable in respect of these agreements are recognised as adjustments to interest expense over the period of the contracts.

Forward currency contracts

The Group enters into forward currency contracts for the purchase and/or sale of foreign currencies in order to manage its exposure to fluctuations in currency rates. With the exception of contracts used for translation hedging purposes, unrealised gains and losses on currency contracts are not accounted for until the maturity of the contract. The cash flows from forward purchase currency contracts are classified in a manner consistent with the underlying nature of the hedged transaction.

Principal Accounting Policies (continued)

Currency swaps

Currency swap agreements are used to manage foreign currency exposures and are accounted for using hedge accounting. In order to qualify for hedge accounting the instrument must be identified to a specific foreign currency asset or liability and must be an effective hedge. Foreign currency loans, where the repayment of principal is hedged by currency swaps, are included in the balance sheet at the Sterling equivalent of the hedged rate. Interest on the loan is charged to the profit and loss account at the hedged rate.

Commodity Instruments

Within the UK, the Group makes use of energy trading derivative financial instruments. These instruments are traded in an established and liquid market place. The Companies Act states that the contracts should be held at the lower of cost or net realisable value. The directors consider that this would not give a true and fair view and consider it appropriate to mark the open derivative positions to market since the marketability of the instruments enables management to decide whether to hold or sell the instruments. The effect of this departure from the historical cost convention on the financial statements for the year is a decrease of £8 million in operating profits (year ended 31 December 2002 £6 million increase) and an increase of £1 million (31 December 2002 £6 million increase) in net assets.

Goodwill

Goodwill arising on consolidation represents the excess or shortfall of the fair value of the consideration given compared to the fair value of the identifiable assets and liabilities acquired. Purchased goodwill is capitalised in the balance sheet and amortised on a straight-line basis through the profit and loss account over a period in line with the directors' view of its estimated minimum useful economic life. Goodwill relating to associates and joint ventures is included within 'investments' in the consolidated balance sheet. Goodwill arising on overseas acquisitions is regarded as a currency asset and is re-translated at each period end at the closing rate of exchange.

Tangible fixed assets

Tangible fixed assets are stated at original cost, net of customer contributions, less accumulated depreciation and any provision for impairment. Impairment losses and any subsequent reversals are recognised in the period in which they are identified. In the case of assets constructed by the Company and its subsidiaries, directly related overheads and commissioning costs are included in cost.

Principal Accounting Policies (continued)

Major assets in the course of construction are included in tangible fixed assets on the basis of expenditure incurred at the balance sheet date. Where borrowings are specifically financing the construction of a major capital project with a long period of development, interest payable, not exceeding the actual amount incurred during the relevant period of construction, is capitalised as part of the cost of the asset and written off over the operational life of the asset.

Customers' contributions towards distribution network assets are credited to the profit and loss account over the life of the distribution network assets to which they relate. The contributions are deducted from the cost of the fixed assets. This is a departure from the Companies Act 1985 which requires fixed assets to be included at their purchase price or production cost and therefore any contribution would be presented as deferred income. However, it is the opinion of the directors that the treatment adopted is necessary to give a true and fair view as the contributions relate directly to the cost of fixed assets used in the distribution network. The negative net book value included within tangible fixed assets at 31 December 2003 was £405 million (31 December 2002 £369 million) and the reduction in depreciation charge during the year was £12 million (year ended 31 December 2002 £12 million).

Operating leases

Rents payable under operating leases are charged to the profit and loss account evenly over the term of the lease. Income from operating leases is included within other operating income in the profit and loss account. Income is recognised on a straight-line basis except where income receipts vary with output or other factors. Any variable element is recognised as earned.

Fixed asset investments

The Group's share of the net assets of associated undertakings and joint ventures is included in the consolidated balance sheet. Other fixed asset investments are stated at cost less any provision for impairment in value. Investments in subsidiary undertakings are stated in the balance sheet of the parent company at cost, less any provision for impairment in value.

Fuel stocks and stores

Fuel stocks and general and engineering stores are stated at the lower of cost and net realisable value. In general, stocks are recognised in the profit and loss account on a weighted average cost basis. The Companies Act 1985 requires stocks to be categorised between raw materials, work in progress and finished goods. Fuel stocks and stores are raw materials under this definition.

Cash and short-term deposits

Short-term deposits include cash at bank and in hand, and certificates of tax deposit.

Principal Accounting Policies (continued)

Deferred taxation

Deferred taxation arises in respect of items where there is a timing difference between their treatment for accounting purposes and their treatment for taxation purposes. Full provision is made for such timing differences as required under Financial Reporting Standard 19 'Deferred tax' (FRS 19) on a discounted basis. Such timing differences arise primarily from the differing treatment for taxation and accounting purposes of provisions and depreciation of fixed assets.

Deferred tax liabilities are recognised in respect of all timing differences that have originated but not reversed at the balance sheet date. Deferred tax assets are only recognised to the extent that their recovery is probable.

Pensions

The Group provides pension benefits through both defined benefit and defined contribution schemes. Defined benefit pension scheme costs are charged to the profit and loss account so as to spread the cost of pensions over employees' remaining working lives. The regular cost, and any variation from regular cost which is identified as a result of actuarial valuations, is amortised over the average expected remaining service lives of members. Details of these actuarial valuations, including the frequency and methodology, are set out in note 21. Differences between the amounts funded and the amounts charged to the profit and loss account are treated as either creditors or debtors in the balance sheet. Payments to defined contribution schemes are charged against profits as incurred.

The Group has adopted the transitional provisions of Financial Reporting Standard 17 'Retirement benefits' (FRS 17) in these accounts. In accordance with the transitional arrangements under FRS 17 full implementation of the standard has been deferred. The transitional disclosures are set out in note 21 to the accounts.

Related party transactions

The Company is exempt under the terms of Financial Reporting Standard 8 from disclosing related party transactions with entities that are part of the E.ON Group or investees of the E.ON Group.

Cash flow statement

The Company is a wholly owned subsidiary undertaking of E.ON AG, the ultimate parent undertaking of the E.ON Group, and is included in the publicly available consolidated financial statements of E.ON AG. Consequently, the Company has taken advantage of the exemption from preparing a cash flow statement under the terms of Financial Reporting Standard 1 (revised 1996).

Notes to the financial statements
for the year ended 31 December 2003

1 Turnover

Turnover is analysed as follows:

	Year ended 31 December 2003 £m	Year ended 31 December 2002 £m
UK Operations		
Electricity and gas – wholesale and trading	**2,282**	2,104
Electricity – distribution	**303**	289
Electricity and gas – retail	**4,324**	2,417
Internal charges from distribution to retail	**(137)**	(125)
	6,772	4,685
Asian Asset Management	**-**	15
	6,772	4,700

The Group's share of associates' and joint ventures' turnover is analysed as follows:

	Year ended 31 December 2003 £m	Year ended 31 December 2002 £m
UK Operations	**50**	99
Asian Asset Management	**93**	120
	143	219

Turnover analysed by geographic destination is not materially different from the analysis by origin shown above.

2 Operating costs

Operating costs were as follows:

	Year ended 31 December 2003 £m	Year ended 31 December 2002 £m
Fuel costs	**369**	366
Pool purchases and other costs of sales	**5,041**	3,313
Staff costs (note 4)	**225**	203
Depreciation, including exceptional charges	**162**	167
Goodwill amortisation	**181**	90
Other operating charges, including restructuring costs	**640**	497
Operating costs, after exceptional items	**6,618**	4,636

Operating costs, before exceptional items	**6,495**	4,588
Exceptional operating charges (note 3)	**123**	48

The directors believe that the nature of the Group's business is such that the analysis of operating costs as set out in the Companies Act 1985 is not appropriate. As required by the Act, the directors have therefore adopted the presented format so that operating costs are disclosed in a manner appropriate to the Group's principal activities.

2 Operating costs (continued)

£4 million of foreign exchange losses were recognised in the profit and loss account (year ended 31 December 2002 £72 million losses).

Operating costs also include:	**Year ended 31 December 2003 £m**	Year ended 31 December 2002 £m
Repairs and maintenance costs	**103**	98
Research and development costs	**2**	2
Operating leases	**24**	17
Loss on disposal of fixed assets	**9**	2
Auditors' remuneration for:		
Statutory audit	**1.0**	0.8
Audit related regulatory reporting	**0.2**	0.2
Further assurance services	**0.5**	1.3
Tax services	**0.3**	0.4
General consulting	**-**	1.5

Auditors' remuneration in respect of the Company was £0.3 million for each of the two years ended 31 December 2003.

Other operating income includes £100 million (year ended 31 December 2002 £100 million) of deferred income in respect of the provision of services under warranty arrangements associated with the disposal of Fiddlers Ferry and Ferrybridge C power stations to Edison Mission Energy during 1999.

3 Exceptional items

Exceptional items comprise:

	Year ended 31 December 2003 £m	Year ended 31 December 2002 £m
Charged against operating profit	**(123)**	(48)
Profits less losses on disposal of fixed assets and investments	**-**	-
Profits less losses on disposal of businesses (including provisions)	**8**	388
Exceptional items before taxation	**(115)**	340
Tax on exceptional items	**10**	84
Exceptional items after taxation	**(105)**	424

3 Exceptional items (continued)

Year ended 31 December 2003

UK Operations

Following the acquisition of TXU in October 2002, the UK Operations undertook a detailed review of its UK Operations and established a business reorganisation and restructuring programme. £123 million was charged during the year in respect of that programme, which primarily comprises committed severance and related payments to approximately 1,200 employees, together with costs in respect of rationalisation of IT systems and related infrastructure costs. A tax credit of £10 million arose as a result of this charge.

Charged against operating profit

Year ended 31 December 2002

UK Operations and Corporate

Following the acquisition of the Group by E.ON on 1 July 2002 a number of senior directors and employees left the Powergen Group. At the time, certain restructuring initiatives were undertaken. This has resulted in costs being incurred within UK Operations (£32 million) and within the Corporate Centre (£16 million). The UK Operations reorganisation is still ongoing and further costs will arise in 2003 following the TXU acquisition. A tax credit of £9 million arose as a result of these transactions.

Profit less losses on disposal of fixed assets and investments

Year ended 31 December 2003

Asian Asset Management

As part of Powergen's ongoing strategy to withdraw from the international markets, indicative bids have been received for the 35% investment in PT Jawa Power (Paiton). As a result of these bids, the carrying value of that investment has been reviewed and impaired by £25 million. No tax credit arose as a result of this impairment.

On 16 April 2003, Powergen completed the sale of its remaining indirect 18.4% interest in Yallourn power station in Australia to CLP International (CLP) for proceeds of £41 million. Net assets disposed of totalled £16 million giving rise to an exceptional profit of £25 million. No tax charge arose as a result of this disposal.

3 Exceptional items (continued)

Profits less losses on disposal of businesses (including provisions)

Year ended 31 December 2003

Asian Asset Management

On 11 June 2003, Powergen completed the sale of its remaining investment in CLP Powergen India Limited (CPIL) to CLP for proceeds of £28 million. Net assets disposed, together with related disposal costs totalled £20 million giving rise to a profit on disposal of £8 million. No tax charge arose as a result of this disposal.

Year ended 31 December 2002

Asian Asset Management

On 28 February 2002, the Group completed the sale of its 88 per cent stake in Gujarat Paguthan Energy Corporation Pvt. Limited ('GPEC') to CPIL, a company that is 80 per cent owned by CLP and 20 per cent owned by the Powergen UK Group. Proceeds received were £202 million. Net assets disposed of, together with related disposal costs, were £209 million giving rise to a loss on disposal of £7 million.

On 20 February 2002, the Group acquired the remaining 12 per cent of GPEC it did not previously own and, on 23 October 2002, sold this stake to CPIL. Proceeds received were £21 million and the book value of assets disposed of including provisions were £25 million, giving rise to a loss of £4 million.

On 8 November 2002, the Group finalised the terms of sale of its investment in CPIL to CLP. The value of the Group's investment has been impaired by £18 million to reflect the value implicit in this agreement. No tax charge arose as a result of this series of transactions.

Corporate

On 13 June 2002, the Group sold a subsidiary undertaking, Powergen Investments Limited, to Powergen Group Investments Limited, the immediate parent undertaking. Consideration received was £1 and net liabilities disposed of were £417 million giving rise to an exceptional profit of £417 million. No tax credit arose as a result of this transaction.

Tax credit

Year ended 31 December 2002

UK Operations

In addition to the tax charges and credits detailed above, during March 2002 the Group reached agreement with the Inland Revenue with regard to the principles for the valuation of certain power stations for capital gains tax purposes. As a result of this agreement, £75 million of tax previously provided for on the disposal in 1999 of Fiddler's Ferry and Ferrybridge C power stations was released as an exceptional profit through the tax line in 2002.

4 Employee information, including directors' remuneration

The average number of persons employed by the Group, including executive directors, analysed by activity was:

	Year ended 31 December 2003	Year ended 31 December 2002
UK Operations (including Corporate Centre)	**6,397**	5,959
Asian Asset Management	**320**	364
	6,717	6,323

The salaries and related costs of employees, including directors, were:

	Year ended 31 December 2003 £m	Year ended 31 December 2002 £m
Wages and salaries	**206**	176
Social security costs	**19**	15
Other pension costs (note 21)	**13**	20
	238	211
Capitalised in fixed assets	**(13)**	(8)
Charged in profit and loss account as staff costs	**225**	203

The total remuneration of the Company's directors, together with details of the individual remuneration of the highest paid director are as follows:

All directors	**Year ended 31 December 2003 £**	Year ended 31 December 2002 £
Aggregate emoluments	**888,848**	1,244,221
Compensation for loss of office	**-**	6,044,716
	888,848	7,288,937

Retirement benefits are accruing to two directors under a defined benefit pension scheme (31 December 2002: two). During the year no (2002: two) directors exercised options over shares they were awarded for services to the Powergen Group.

Notes to the financial statements
for the year ended 31 December 2003 (continued)

4 Employee information, including directors' remuneration (continued)

Highest paid director	**Year ended 31 December 2003 £**	Year ended 31 December 2002 £
Total emoluments, excluding gains on the exercise of share options and benefits under long-term incentive schemes	**550,295**	447,258
Defined benefit pension scheme:		
- Accrued pension at end of year	**71,000**	47,980

5 Net interest payable – Group

	Year ended 31 December 2003 £m	Year ended 31 December 2002 £m
Interest receivable		
From associates and joint ventures	**6**	6
From fellow E.ON group undertakings	**5**	23
Other	**5**	13
Total interest receivable and similar items	**16**	42
Interest payable		
Bank loans and overdrafts	**-**	(7)
Loans from fellow E.ON group undertakings	**(31)**	(16)
Other loans	**(66)**	(131)
Total interest payable and similar items	**(97)**	(154)
Net interest payable before unwinding of discount	**(81)**	(112)
Unwinding of discount in provisions	**(3)**	(2)
	(84)	(114)

Notes to the financial statements for the year ended 31 December 2003 (continued)

6 Profit on ordinary activities before taxation

	Year ended 31 December 2003 £m	Year ended 31 December 2002 £m
UK Operations		
Electricity and gas – wholesale and trading	**(19)**	91
Electricity – distribution	**155**	129
Electricity and gas – retail	**421**	105
Lease and other income and charges	**26**	83
	583	408
Asian Asset Management	**58**	65
Intra-group foreign exchange differences	**9**	(73)
Corporate costs	**(13)**	(12)
Net interest payable – Group	**(84)**	(114)
- Associates and joint ventures	**(24)**	(30)
	529	244
Goodwill amortisation – UK Operations	**(181)**	(90)
Exceptional items (note 3)	**(115)**	340
	233	494

The Group's share of associates' and joint ventures' operating profit can be analysed as follows:

	Year ended 31 December 2003 £m	Year ended 31 December 2002 £m
UK Operations	**10**	16
Asian Asset Management	**57**	59
	67	75

The net assets of the Group are analysed as follows:

	At 31 December 2003 £m	At 31 December 2002 £m
UK Operations	**4,702**	3,882
Asian Asset Management	**89**	138
Unallocated net liabilities	**(2,337)**	(1,750)
	2,454	2,270

The profits and net assets analysed by geographic destination is not materially different from the analyses by origin shown above.

7 Tax on profit on ordinary activities

	Year ended 31 December 2003 £m	Year ended 31 December 2002 £m
Current tax:		
United Kingdom Corporation tax at 30%	**43**	18
Under/(Over) provision in prior year	**(14)**	(86)
Overseas taxation	**1**	1
Total current tax charge/(credit)	**30**	(67)
Deferred tax:		
Origination and reversal of timing differences	**7**	22
(Increase)/Decrease in discount	**(6)**	11
Total deferred tax charge (note 23)	**1**	33
Associates and joint ventures	**13**	11
Tax charge/(credit) on profit on ordinary activities	**44**	(23)

The effective tax rate is expected to increase in future periods as a result of the conclusion of the period covered by the major parts warranty given to the purchaser on the disposal of Fiddler's Ferry and Ferrybridge C power stations in 1999. Part of the proceeds on the disposal was deferred and is recognised in the profit and loss account over the period covered by the warranty. This deferred income was subject to tax when actually received and is therefore not subject to tax when recognised in the profit and loss account. The effective rate of tax will increase in 2004 and subsequent periods as a result of the warranty period coming to an end.

The difference between the current tax on the profit on ordinary activities for the year and the tax assessed on the profit on ordinary activities for the year assessed at the standard rate of corporation tax in the UK (30%) can be explained as follows:

	Year ended 31 December 2003 £m	Year ended 31 December 2002 £m
Profit on ordinary activities before tax	**233**	494
Tax charge on profit on ordinary activities at 30%	**70**	148
Effects of:		
Prior year adjustment	**(14)**	(86)
Origination and reversal of timing differences	**(22)**	2
Expenses not deductible for tax purposes	**57**	45
Non-taxable income	**(46)**	(161)
Net effect of different rates of tax in overseas businesses	**(2)**	(4)
Associates and joint ventures	**(13)**	(11)
	30	(67)

The tax impact of exceptional items is given in note 3.

8 Dividends

	Pence per ordinary share			
	Year ended 31 December 2003	Year ended 31 December 2002	**Year ended 31 December 2003 £m**	Year ended 31 December 2002 £m
First interim dividend paid	**-**	9.9p	**-**	64

9 Profit of the Company

The loss attributable to shareholders for the financial year of the Company is £106 million (year ended 31 December 2002 £16 million profit). The Company is not publishing a separate profit and loss account as permitted by Section 230 of the Companies Act 1985.

10 Acquisitions and revisions to provisional fair values

On 16 July 2003, Powergen acquired Edenderry Power Limited (Edenderry), a Company based in Ireland, from Ruhrgas Holdings GmbH, a fellow group undertaking. Ruhrgas Holdings GmbH had acquired Edenderry from Fortum on 3 July 2003. The consideration paid by Powergen totalled £9 million and the fair value of the net assets acquired was £9 million. Therefore no goodwill arose as a consequence of this transaction which has been acquisition accounted.

Details of the acquisition are set out as follows:

	Book value £m	Revaluation [1] £m	Fair value to the Powergen Group £m
Net assets acquired:			
Tangible fixed assets	58	(11)	47
Working capital	(38)	-	(38)
	20	(11)	9
Goodwill arising			-
Consideration, including costs of acquisition			9

1 – Revaluation adjustments principally comprise valuation adjustments to the generation plant at fair value

On 25 November 2003, Powergen acquired Solway Offshore Limited and Offshore Energy Resources Limited. These companies hold development rights and the necessary consents to build windfarms in the Solway Firth. The consideration paid was £6 million resulting in goodwill arising of £6 million.

On 21 October 2002, Powergen acquired the UK retail energy business, certain gas supply contracts, and control of three power stations from TXU Europe Group plc (TXU). Two of the three power stations were already owned by Powergen and had been leased to TXU. The third power station was purchased as part of the transaction. The consideration payable totalled £1,627 million in cash, including acquisition costs of £10 million and the repurchase of securitised debtors of £247 million.

10 Acquisitions and revisions to provisional fair values (continued)

The fair value of the net liabilities acquired, as stated in the accounts for the year ended 31 December 2002 was £138 million, leading to goodwill arising of £1,765 million. Due to the proximity of the acquisition to the year end the fair value of the assets and liabilities as presented in the accounts for the year ended 31 December 2002 was provisional. During the current year these fair values have been finalised, as permitted by Financial Reporting Standard 7 ‘Fair values in acquisition accounting’. The final fair value of the net liabilities acquired was £178 million , leading to additional goodwill arising of £40 million, resulting in total goodwill arising of £1,805 million.

Details of the adjustments made to the TXU provisional fair values are set out below and relate to the finalisation of valuations and the tax treatment ascribed to the original provisional adjustments:

	Provisional fair values as previously stated £m	Revisions to provisional fair values £m	Fair value to the Powergen Group £m
Net assets acquired:			
TXU			
Tangible fixed assets	18	(4)	14
Stocks	15	-	15
Deferred taxation	56	(45)	11
Other working capital	(46)	9	(37)
Provisions	(181)	-	(181)
	(138)	(40)	(178)
Goodwill	1,765	40	1,805
Consideration, including costs of acquisition	1,627		1,627

The revision to provisional fair values in respect of deferred taxation arises due to a change in the expected tax treatment of the utilisation of provisions created in respect of certain long term contracts acquired as part of the purchase of TXU.

11 Goodwill

The Group

	£m
Cost	
At 31 December 2002	3,125
Revisions to provisional fair values (note 10)	40
Acquisitions (note 10)	6
31 December 2003	**3,171**
Amortisation	
At 31 December 2002	317
Charge for the year	181
At 31 December 2003	**498**
Net book value at 31 December 2003	**2,673**
Net book value at 31 December 2002	2,808

11 Goodwill (continued)

The Company

	£m
Cost	
At 31 December 2002 and at **31 December 2003**	**32**
Amortisation	
At 31 December 2002	-
Charge for the year	2
At 31 December 2003	**2**
Net book value at 31 December 2003	**30**
Net book value at 31 December 2002	32

12 Tangible fixed assets

The Group	Generating assets £m	Distribution and transmission networks £m	Other operating and short-term assets £m	Total £m
Cost				
At 31 December 2002	3,006	1,708	698	5,412
Revisions to provisional fair values (note 10)	-	-	(4)	(4)
Additions	114	85	17	216
Acquisitions	-	-	47	47
Disposals	(14)	-	(4)	(18)
At 31 December 2003	**3,106**	**1,793**	**754**	**5,653**
Depreciation				
At 31 December 2002	1,909	608	421	2,938
Charge for the year	103	44	15	162
Disposals	(5)	-	(4)	(9)
At 31 December 2003	**2,007**	**652**	**432**	**3,091**
Net book value at 31 December 2003	**1,099**	**1,141**	**322**	**2,562**
Net book value at 31 December 2002	1,097	1,100	277	2,474

Group assets include freehold land and buildings with a net book value of £126 million (31 December 2002 £126 million) and assets in the course of construction at a cost of £33 million (31 December 2002 £272 million).

Notes to the financial statements for the year ended 31 December 2003 (continued)

12 Tangible fixed assets (continued)

The Company	Generating assets £m	Other assets £m	Total £m
Cost			
At 31 December 2002	2,855	134	2,989
Additions	53	9	62
Group transfers	-	8	8
Disposals	(8)	(1)	(9)
At 31 December 2003	**2,900**	**150**	**3,050**
Depreciation			
At 31 December 2002	1,883	116	1,999
Charge for the year	91	6	97
Group transfers	-	6	6
Disposals	(5)	(1)	(6)
At 31 December 2003	**1,969**	**127**	**2,096**
Net book value at 31 December 2003	**931**	**23**	**954**
Net book value at 31 December 2002	972	18	990

Company assets include freehold land and buildings with a net book value of £97 million (year ended 31 December 2002 £100 million).

Notes to the financial statements for the year ended 31 December 2003 (continued)

13 Fixed asset investments

Group	Net assets		Loans			
	Joint ventures	Associates	Joint ventures	Associates	Other investments	**Total**
	£m	£m	£m	£m	£m	**£m**
Net assets excluding goodwill						
At 31 December 2002	43	98	32	12	62	247
Additions	-	-	-	1	-	1
Dividends received	(7)	-	-	-	-	(7)
Disposals	-	(3)	-	-	(46)	(49)
Impairment	-	(25)	-	-	-	(25)
Retained profits	3	27	-	-	-	30
Foreign exchange movements	-	(12)	-	-	-	(12)
At 31 December 2003	**39**	**85**	**32**	**13**	**16**	**185**
Goodwill						
At 31 December 2002	6	-				6
Amortisation	-	-				-
At 31 December 2003	**6**	**-**				**6**
At 31 December 2003 – Net assets and goodwill	**45**	**85**	**32**	**13**	**16**	**191**
At 31 December 2002 – Net assets and goodwill	49	98	32	12	62	253

Company	Subsidiary investment		Associate investment		Other	Total
	Equity	Loans	Equity	Loans	Investments	
	£m	£m	£m	£m	£m	£m
At 31 December 2002	2,387	107	12	35	19	2,560
Additions	501	430	-	-	-	931
Disposals	-	(515)	-	-	(4)	(519)
Reclassify as short term assets	-	(22)	-	-	-	(22)
At 31 December 2003	**2,888**	**-**	**12**	**35**	**15**	**2,950**

13 Fixed asset investments (continued)

Interests in Group subsidiary undertakings

Details of the Group's principal investments in subsidiary undertakings are set out below. Principal subsidiaries are those which in the opinion of the directors significantly affect the amount of profit and assets and liabilities shown in these accounts. The directors consider that those companies not listed are not significant in relation to the Group as a whole.

Name	Class of share capital	Proportion of nominal value of issued equity shares and voting rights held by the Group or the Company %	Country of incorporation or registration	Principal business activities
Central Networks East plc + (formerly East Midlands Electricity plc)	Ordinary shares	100	England and Wales	Distribution of electricity
Powergen International Limited *	Ordinary shares	100	England and Wales	Holding company for international activities
Powergen CHP Limited *	Ordinary and preference shares	100	England and Wales	Sale of energy services involving the construction of combined heat and power (CHP) plant
Powergen Cogeneration Limited*	Ordinary shares	100	England and Wales	Sale of energy services involving the construction of combined heat and power (CHP) plant
Powergen Gas Limited *	Ordinary shares	100	England and Wales	Transportation and marketing of gas in the UK
Powergen Retail Limited +	Ordinary shares	100	England and Wales	Supply of electricity and supply, trading and shipping of gas in the UK
Powergen Renewables Holdings Limited *	Ordinary shares	100	England and Wales	Holding company for renewable activities

* direct interest + indirect interest

13 Fixed asset investments (continued)

Associates and joint ventures

Details of the Group's principal investments in associates and joint ventures are as follows:

	Accounting reference date	Country of incorporation or registration	Shares held	Percentage of capital held directly or indirectly by the Company
PT Jawa Power	31 December	Indonesia	Indonesian rupees ordinary shares	35%
Corby Power Limited *	30 September	England and Wales	Ordinary shares	50%
Cottam Development Centre Limited *	31 December	England and Wales	Ordinary shares	50%

* treated as joint ventures in the Group's accounts

The principal activities of these associates and joint ventures are:

PT Jawa Power	-	Generation and sale of electricity from coal-fired power station
Corby Power Limited	-	Generation and sale of electricity from gas-fired power station
Cottam Development Centre Limited	-	Construction and operation of gas-fired power station plant and operation of a generator turbine testing facility

On 26 January 2004, Powergen acquired the remaining issued share capital of Cottam Development Centre Limited, giving the Group 100% ownership

Group share of aggregate associates' and joint ventures' balance sheets

	At 31 December 2003		At 31 December 2002	
	Joint ventures £m	**Associates £m**	Joint ventures £m	Associates £m
Share of assets:				
Share of fixed assets	**128**	**277**	124	360
Share of current assets	**18**	**76**	21	56
	146	**353**	145	416
Share of liabilities:				
Amounts falling due within one year	**(18)**	**(15)**	(8)	(24)
Amounts falling due after more than one year	**(83)**	**(253)**	(88)	(294)
	(101)	**(268)**	(96)	(318)
Share of net assets	**45**	**85**	49	98
Turnover	**48**	**95**	68	151
Operating profit	**9**	**58**	14	61

Notes to the financial statements for the year ended 31 December 2003 (continued)

14 Stocks

	The Group		The Company	
	At 31 December 2003 £m	At 31 December 2002 £m	**At 31 December 2003 £m**	At 31 December 2002 £m
Fuel stocks	**61**	77	**60**	76
Stores	**29**	33	**20**	27
	90	110	**80**	103

15 Debtors: amounts falling due after more than one year

	The Group		The Company	
	At 31 December 2003 £m	At 31 December 2002 £m	**At 31 December 2003 £m**	At 31 December 2001 £m
Other debtors	**10**	17	**10**	3

16 Debtors: amounts falling due within one year

	The Group		The Company	
	At 31 December 2003 £m	At 31 December 2002 £m	**At 31 December 2003 £m**	At 31 December 2002 £m
Trade debtors	**998**	1,046	**397**	199
Other debtors	**111**	80	**101**	59
Prepayments and accrued income	**57**	60	**35**	70
Amounts due from fellow group undertakings	**68**	1,813	**1,435**	4,984
	1,234	2,999	**1,968**	5,312

17 Loans and overdrafts

	The Group		The Company	
	At 31 December 2003 £m	At 31 December 2002 £m	**At 31 December 2003 £m**	At 31 December 2002 £m
Bank overdrafts	**43**	12	**105**	62
Short term loans from E.ON Group companies	**1,274**	491	**149**	491
Other short-term loans	**-**	250	**-**	250
	1,317	753	**254**	803

During 2002 and the first six months of 2003, the Group had a Euro Commercial Paper programme which allowed it to issue paper in various currencies for maturities of seven to 364 days up to a maximum of US $500 million or equivalent at LIBOR rates. At 31 December 2002, no amounts were drawn down under this programme. Short-term funding is now provided through inter-company facilities rather than using the external commercial paper programme, and therefore on 7 July 2003 the programme was cancelled. The weighted average interest rate on all short-term loans during the year was 1.9% (year ended 31 December 2002 5.6%).

18 Trade and other creditors falling due within one year

	The Group		The Company	
	At 31 December 2003 £m	At 31 December 2002 £m	**At 31 December 2003 £m**	At 31 December 2002 £m
Trade creditors	**930**	770	**585**	481
Amounts owed to parent undertaking and fellow subsidiaries	**105**	2,468	**95**	1,968
Amounts owed to subsidiaries	**-**	-	**1,549**	2,054
Corporation tax	**58**	63	**58**	58
Other taxation and social security	**9**	8	**6**	4
Accruals and other creditors	**251**	570	**146**	161
Deferred income	**40**	100	**40**	100
	1,393	3,979	**2,479**	4,826

Accruals and other creditors include accruals for rationalisation and restructuring costs of the Group. The Group is not committed to significant payments under operating or finance leases during the next financial year.

Notes to the financial statements
for the year ended 31 December 2003 (continued)

19 Long term loans

	The Group		The Company	
	At 31 December 2003 £m	At 31 December 2002 £m	**At 31 December 2003 £m**	At 31 December 2002 £m
8.5% Sterling Bond 2006	**250**	250	**250**	250
7.45% US Dollar Yankee Bond 2007	**237**	262	**-**	-
Intra-Group swaps	**19**	(5)	**-**	-
	256	257	**-**	-
Loan notes 2007	**2**	3	**-**	-
5% Euro Eurobond 2009	**326**	326	**326**	326
6.25% Sterling Eurobond 2024	**245**	245	**245**	245
	1,079	1,081	**821**	821

None of the bonds outstanding at 31 December 2003 has any financial covenants.

The maturity profile of the financial liabilities, including overdrafts and long-term loans, is as follows:

	At 31 December 2003 £m	At 31 December 2002 £m
Group		
In one year or less, or on demand	**1,317**	753
In more than two years but not more than five years	**508**	510
In more than five years	**571**	571
	2,396	1,834
Company		
In one year or less, or on demand	**254**	803
In more than two years but not more than five years	**250**	250
In more than five years	**571**	571
	1,075	1,624

At 31 December 2003 there were £156 million of undrawn committed borrowing facilities available to the Group, all of which were inter-company facilities which did not contain any material covenant restrictions and expire within 12 months from the balance sheet date. These facilities comprise:

19 Long term loans (continued)

Facility	Total facility £m	Amount indrawn at 31 December 2003 £m	Expiry date	Fees
Powergen UK plc – committed facility from E.ON AG *	150	141	January 2004	10bps
Powergen UK plc – committed facility from Raab Karcher Electronic Systems plc	20	15	October 2004	-
	170	**156**		

* This facility was extended to July 2004 and increased to £450 million.

20 Other creditors falling due after more than one year

	The Group		The Company	
	At 31 December 2003 £m	At 31 December 2002 £m	**At 31 December 2003 £m**	At 31 December 2002 £m
Accruals and other creditors	**129**	116	**86**	76
Deferred income	**-**	40	**-**	40
Amounts due to subsidiary undertakings	**-**	-	**319**	319
	129	156	**405**	435

21 Pension scheme arrangements

At 31 December 2003, Powergen had both statutorily approved defined benefit pension schemes and several smaller statutorily approved defined contribution schemes.

Powergen participates in the UK industry-wide scheme, the Electricity Supply Pension Scheme (ESPS), for the majority of its UK based employees. This is a funded scheme of the defined benefit type, with assets invested in separate trustee administered funds. At 31 December 2003, the Group has three separate funds with the ESPS, the Powergen fund, the East Midlands Electricity fund and the TXU fund. An actuarial valuation of the ESPS is normally carried out every three years by the Scheme's independent, professionally qualified actuary, who recommends the rates of contribution payable by each group participating in the scheme. In intervening years the actuary reviews the continuing appropriateness of the rates.

Notes to the financial statements
for the year ended 31 December 2003 (continued)

21 Pension scheme arrangements (continued)

The latest published actuarial valuation of the ESPS was at 31 March 2001. Particulars of this actuarial valuation are shown below. The 2001 valuation revealed surpluses of £237 million in respect of the Powergen fund and £116 million in respect of the East Midlands Electricity fund. A fair value exercise was completed by an independent actuary upon the acquisition of TXU in 2002. This valuation showed a deficit of £51 million. Details of the market value of assets implicit in these valuations, and the major assumptions used in the preparation of these valuations were:

	At 31 March 2001		At 21 October 2002
	Powergen fund	East Midlands Electricity fund	TXU fund
Market value of assets*	£1,604m	£954m	£836m
Funding level	117%	114%	96%
– average nominal rate of return on investments (pre-retirement)	6.3%	6.3%	6.6%
– average nominal rate of return on investments (post-retirement)	5.3%	5.3%	5.6%
– average nominal rate of annual increase in salaries	3.8%	3.8%	3.3%
– average nominal rate of annual increase in pensions	2.5%	2.5%	2.5%
Inflation rate	2.3%	2.3%	2.3%
Method of valuation used	Projected unit	Projected unit	Projected unit

* Assets are taken at a smoothed asset valuation for SSAP 24 purposes. The smoothed value of assets at 31 March 2001 was 102% and 100% of the market value of the assets for the Powergen and East Midlands Electricity funds respectively.

The funding policy differs from the accounting policy in that it uses a more conservative basis for valuation.

Pension costs for the Group

In the financial year ended 31 December 2003, the normal pension cost for the Group amounted to £13 million (year ended 31 December 2002 £20 million). Surpluses and deficits are spread as a fixed percentage of total pensionable salaries over the average remaining service lives of members. At 31 December 2003, the Group had a SSAP 24 creditor of £132 million (31 December 2002 £135 million).

21 Pension scheme arrangements (continued)

Impact of FRS 17

SSAP 24 disclosure and measurement principles have been applied in accounting for pensions and post-retirement benefits in these financial statements. However, FRS 17 'Retirement benefits' introduces additional disclosure requirements.

The aim of FRS 17 is to move to a market-based approach in valuing the assets and liabilities arising from an employer's retirement benefit obligations and any associated funding. The changes in accounting required to move from a SSAP 24 basis to a market value basis are substantial, and consequently FRS 17 allows a phased implementation of these changes. The disclosures required which are designed to illustrate the entries which would have been made if the measurements principles of FRS 17 have been applied are set out below.

In calculating these disclosures, the figures shown for liabilities have been measured by updating valuations which were performed at 31 March 2001 and various dates between 31 March 2001 and 31 December 2003. The updates were performed by independent, professionally qualified actuaries.

The major assumptions used in these calculations of liabilities were:

	31 December 2003	31 December 2002	31 December 2001
Average nominal rate of annual increase in salaries	4.00%	3.75%	4.00%
Average nominal rate of annual increase in pensions	2.50%	2.25%	2.50%
Discount rate	5.50%	5.75%	5.50%
Inflation rate	2.50%	2.25%	2.50%

The fair market value of the assets of the main defined benefit schemes together with the liabilities calculated in accordance with FRS 17 at 31 December were:

	2003	2002	2001
Bonds and gilts	**1,093**	865	424
Equities	**1,562**	1,563	1,831
Property	**196**	179	107
Other	**41**	42	51
Total market value of assets	**2,892**	2,649	2,413
Present value of scheme liabilities	**(3,432)**	(3,151)	(2,285)
Deficit in the scheme	**(540)**	(502)	128
Related deferred tax asset	**91**	81	(38)
Net pension liability	**(449)**	(421)	90

21 Pension scheme arrangements (continued)

The long-term rates of return assumed on these assets were as follows:

	31 December 2003 %	31 December 2002 %	31 December 2001 %
Bonds and gilts	**5.18**	5.20	5.00
Equities	**7.75**	8.25	7.00
Property	**7.75**	8.25	-
Other	**3.75**	4.00	4.00

If FRS 17 had been adopted in the financial statements, the Group's net assets and profit and loss reserve would be as follows:

	2003 £m	2002 £m
Net assets at 31 December	**2,454**	2,270
SSAP 24 pension liabilities (net of tax)	**107**	110
Net assets excluding SSAP 24 liabilities	**2,561**	2,380
Pension and other post-retirement benefit liability under FRS 17	**(449)**	(421)
Net assets including pension liability under FRS 17	**2,112**	1,959
Profit and loss reserve as at 31 December	**1,454**	1,269
SSAP 24 pension liabilities (net of tax)	**107**	110
Profit and loss reserve excluding SSAP 24 liabilities	**1,561**	1,379
Pension and other post-retirement benefit liability under FRS 17*	**(449)**	(421)
Profit and loss reserve including pension liability under FRS 17	**1,112**	958

If FRS 17 had been adopted in the financial statements, the following would have been included in the Group's profit and loss account:

	Year ended 31 December 2003 £m	Year ended 31 December 2002 £m
Operating profit		
Current service cost	**19**	18
Past service cost	**53**	48
Total operating charge	**72**	66
Other finance income		
Expected return on pension scheme assets	**186**	163
Interest on pension scheme liabilities	**(177)**	(131)
Net return	**9**	32

21 Pension scheme arrangements (continued)

If FRS 17 had been adopted in the financial statements, the following would have been included in the Group's STRGL for the years ended 31 December:

	2003 **£m**	2002 £m
Actual return less expected return on pension scheme assets	**208**	(539)
Experience losses arising on the scheme liabilities	**-**	(66)
Gains resulting from changes in assumptions underlying the present value of the scheme liabilities	**(260)**	178
Actuarial loss recognised in the STRGL	**(52)**	(427)

The movement in the deficit during the year is analysed as follows:

	Year ended 31 December 2003 £m	Year ended 31 December 2002 £m
(Deficit)/Surplus at the beginning of the year	**(502)**	128
Fair value on the acquisition of TXU	**-**	(188)
Current service cost	**(19)**	(18)
Employer contributions	**77**	19
Past service costs	**(53)**	(48)
Other finance income	**9**	32
Actuarial loss recognised in the STRGL	**(52)**	(427)
Deficit in the schemes at the end of the year	**(540)**	(502)

The details of experience gains and losses under FRS 17 for the years ended 31 December are as follows:

	2003	2002
Differences between the expected and actual return on scheme assets:		
Amount	**£208m**	£(539)m
Percentage of scheme assets at year end	**7%**	(20)%
Experience gains and losses of scheme liabilities:		
Amount	**-**	£(66)m
Percentage of the present value of the scheme liabilities at the year end	**-**	(2)%
Total amount recognised in the statement of total recognised gains and losses:		
Amount	**£(52)m**	£(427)m
Percentage of the present value of the scheme liabilities at the year end	**(2)%**	(14)%

Contributions in the year ended 31 December 2003 were £77 million (year ended 31 December 2002 £19 million). It has been agreed that the contributions will be 12% of pension able salary in the forthcoming year depending upon the outcome of the actuarial review as at 31 March 2004.

22 Provisions for liabilities and charges

Movements on provisions comprise:

The Group	31 December 2002 £m	Charged/ (Released) to the profit and loss account £m	Amortisation of discount £m	Provisions utilised £m	**31 December 2003 £m**
Liability and damage claims	11	1	-	-	**12**
Contract provisions	252	(44)	-	(83)	**125**
Decommissioning	80	(3)	3	(6)	**74**
	343	(46)	3	(89)	**211**

At 31 December 2003, the provisions in the Company's accounts were as follows:

The Company	31 December 2002 £m	Charged/ (Released) to the profit and loss account £m	Transfer from Group companies £m	Amortisation of discount £m	Provisions utilised £m	**31 December 2003 £m**
Liability and damage claims	11	1	-	-	**-**	**12**
Contract provisions	-	-	5	-	**-**	**5**
Decommissioning	71	(2)	-	3	(6)	**66**
	82	(1)	5	3	(6)	**83**

The liability and damage claims provision includes reserves in respect of potential claims for pension rationalisation costs. Given the inherent uncertainty surrounding the timing of any potential claims, it is not possible to estimate when these amounts will crystallise.

Contract provisions include two items. The first of these relates to out of money electricity purchase contracts, which were acquired on the purchase of East Midlands Electricity and will be utilised over the period to 2008, when the contracts terminate. The second contract provision was acquired with the purchase of TXU and relates to an out of money outsourced retail service contract arrangement. This provision will be utilised over the period to 2005 when the contract becomes due for renewal.

Decommissioning provisions comprise amounts set aside for the estimated costs of terminating power station grid connections, decommissioning power stations and subsequent site restoration costs at UK power stations which will be utilised as each power station closes.

23 Deferred tax

An analysis of the full provision and discounted provision for deferred tax recognised at 31 December 2003 is as follows:

The Group	**At 31 December 2003 £m**	At 31 December 2002 £m
Accelerated capital allowances	**418**	424
Other timing differences	**(64)**	(122)
Undiscounted provision for deferred tax	**354**	302
Discount	**(136)**	(130)
Discounted provision for deferred tax	**218**	172
Provision at start of year	**172**	191
Acquisitions	**-**	(52)
Revisions to provisional fair values (note 10)	**45**	-
Deferred tax charge for year (note 7)	**1**	33
Provision at end of year	**218**	172

The Company	**At 31 December 2003 £m**	At 31 December 2002 £m
Accelerated capital allowances	**195**	213
Other timing differences	**(45)**	(41)
Undiscounted provision for deferred tax	**150**	172
Discount	**(49)**	(52)
Discounted provision for deferred tax	**101**	120

The undiscounted liability in respect of accelerated capital allowances and other timing differences is calculated at 30% in both periods.

Notes to the financial statements
for the year ended 31 December 2003 (continued)

24 Share capital

The share capital of the Company comprises:

	At 31 December 2003 £m	At 31 December 2002 £m
Authorised		
1,050,000,002 ordinary shares of 50p each	**525**	525
Allotted, called-up and fully paid		
649,241,799 ordinary shares of 50p each	**325**	325

25 Reserves

The Group	Share premium account £m	Special capital reserve £m	Revaluation reserve £m	Capital redemption reserve £m	Profit and loss account £m
At 31 December 2002	97	474	16	85	1,269
Currency translation differences on foreign currency net investments	-	-	-	-	(5)
Revaluation transfer	-	-	(1)	-	1
Retained profit for the year	-	-	-	-	189
At 31 December 2003	**97**	**474**	**15**	**85**	**1,454**

The Company	Share premium account £m	Special capital reserve £m	Capital redemption reserve £m	Profit and loss account £m
At 31 December 2002	97	474	85	987
Loss for year	-	-	-	(106)
At 31 December 2003	**97**	**474**	**85**	**881**

The share premium account, special capital reserve and capital redemption reserve are not available for distribution. The special capital reserve was determined in accordance with the Transfer Scheme made pursuant to the Electricity Act 1989, under which the CEGB's net assets were vested in its successor companies.

26 Equity minority interests

The Group	**31 December 2003 £m**	31 December 2002 £m
Opening equity minority interests	**4**	33
Acquisition of GPEC minorities	**-**	(34)
Partial sale of subsidiaries (see below)	**-**	4
Profit and loss account	**-**	1
Closing equity minority interests	**4**	4

On 14 May 2002, the Company sold 4,000,000 £1 preference shares issued by Ergon Properties Limited (EPL), a subsidiary undertaking, to Ergon Insurance Limited, a fellow group undertaking. Proceeds received were £41,000,000. On 27 June 2002, EPL paid a special dividend on these shares of £37,178,300 which left the value of these shares at the par value of £4,000,000, as shown above.

27 Reconciliation of movements in shareholders' funds

	31 December 2003 £m	31 December 2002 £m
Profit for the financial year	**189**	516
Dividends	**-**	(64)
Currency translation differences on foreign currency net investments	**(5)**	(13)
Revaluation reserve arising on acquisition	**-**	16
Net increase in shareholders' funds for the year	**184**	455
Opening shareholders’ funds	**2,266**	1,811
Closing shareholders’ funds	**2,450**	2,266

28 Financial instruments

Financial instruments and risk management

As part of the financing of its normal operating activities, the Group uses a variety of financial instruments. These may be assets, liabilities or related commitments depending on requirements. These instruments are denominated in Sterling or foreign currencies and have various maturities and interest rates. The Group is exposed to movements in market interest rates and foreign currency exchange rates. Active steps are taken to manage these risks, both by management of the portfolio of financial instruments themselves, and by the use of derivative financial instruments, which are primarily used where there is an underlying exposure.

The objectives, policies and strategies connected with the use of financial instruments are discussed in the 'Treasury management' section of the Directors' Report.

The Group may be exposed to credit related loss in the event of non-performance by counter-parties under these instruments. However, the Group does not anticipate any non-performance given the high credit rating of the established banks and financial institutions that form these counter-parties. The Group controls this credit risk through credit approvals, strict exposure limits, monitoring procedures and specific controls depending on the size of individual transactions.

There are no significant concentrations of credit risk. The Group does not usually require collateral or other security to support financial instruments with credit risks.

Foreign exchange risk management

The Group enters into foreign exchange contracts in accordance with its hedging policies. These policies are discussed under 'Foreign exchange risk management' in the Directors' Report. The net Sterling notional amounts of each foreign currency the Group has contracted to purchase (or sell) are as follows:

	At 31 December 2003 £m	At 31 December 2002 £m
US Dollars	**95**	(17)
Euros	**8**	-
Australian dollars	**-**	(17)
	103	(34)

28 Financial instruments (continued)

Some contracts involve purchases or sales of US Dollars against other, non-Sterling currencies. The Sterling equivalent notional amounts of these contracts are as follows:

	At 31 December 2003 £m	At 31 December 2002 £m
Euros	**-**	1
Indian rupees	**-**	(34)
	-	(33)

The weighted average time to maturity of foreign exchange contracts is seven months (31 December 2002 two months).

The notional amounts of foreign currency swaps are as follows:

	At 31 December 2003 £m	At 31 December 2002 £m
Foreign currency swaps into Sterling	**582**	580

There are no material monetary assets or liabilities of the Group that are not denominated in the functional currency of the entity concerned, other than certain non-Sterling borrowings treated as hedges of net investments in overseas operations.

Interest rate risk management

The Group has a portfolio of fixed and floating interest rate debt and, in order to mitigate interest rate risk, arranges interest rate hedges to achieve a desired mix of fixed and floating interest rates, with a range of different maturities, as described in the Directors' Report. The notional amounts of these instruments used can be summarised as follows:

	At 31 December 2003 £m	At 31 December 2002 £m
Interest rate swap contracts	**797**	603

The weighted average time to maturity of interest rate swap contracts is 4.0 years. (31 December 2002 4.1 years).

Notes to the financial statements
for the year ended 31 December 2003 (continued)

28 Financial instruments (continued)

Interest rate risk profile of financial liabilities

	Total £m	Floating rate financial liabilities £m	Fixed rate financial liabilities £m	Weighted average interest rate %	Weighted average period for which rate is fixed Years
At 31 December 2003					
Sterling	**2,396**	**1,552**	**844**	**5.7**	**7.3**
At 31 December 2002					
Sterling	1,834	1,095	739	8.3	7.0

The figures in the above table are stated after taking account of relevant interest rate swap contracts.

The floating rate financial liabilities bear interest at variable rates, in some cases fixed in advance for periods up to one year. The floating rates are determined with reference to Sterling LIBOR.

In addition to the above, the Group's provisions include £125 million (31 December 2002 £252 million) for contract provisions (see note 22) which meet the definition of financial liabilities under Financial reporting Standard 13 'Derivatives and other financial instruments'. These financial liabilities are considered to be floating rate liabilities as, in establishing the provisions; the cash flows have been discounted. The discount rate is re-appraised at each reporting date to ensure that it reflects current market assessments of the time value of money and the risks specific to the liability.

At 31 December 2003, the Group held £40 million (31 December 2002 £89 million) of financial assets in the form of Sterling bank deposits, no (31 December 2002 £1 million) US Dollar deposits, and £1 million (31 December 2002 £3 million) in other currency deposits. These deposits earn interest at floating rates, fixed in advance for periods up to three months, by reference to Sterling LIBID .

Fair value

Translation hedging instruments are recorded at fair value in these accounts. The fair value of all other financial instruments, which reflects the estimated amounts Powergen would receive or pay to terminate the contracts at the year end based on market values, is shown below. The fair values therefore reflect current unrealised gains/ (losses) on all open contracts.

	31 December 2003 £m	31 December 2002 £m
Foreign currency contracts	**(14)**	(4)
Foreign currency swaps	**11**	9
Interest rate swaps	**23**	26

Notes to the financial statements for the year ended 31 December 2003 (continued)

28 Financial instruments (continued)

The estimated fair values of the Group's financial assets and liabilities are as follows:

	Note	31 December 2003 Carrying amount £m	31 December 2003 Fair value £m	31 December 2002 Carrying amount £m	31 December 2002 Fair Value £m
Assets					
Cash and short-term deposits	1	**41**	**41**	93	93
Investments	2	**16**	**16**	62	62
Liabilities					
Short-term debt	3,5	**(1,317)**	**(1,317)**	(753)	(753)
Long term debt	4,5	**(1,079)**	**(1,164)**	(1,081)	(1,171)

1. The fair value of short-term deposits approximates to carrying value due to the short maturity of instruments held.
2. The fair value of investments listed on a recognised stock exchange is estimated at quoted market price. Others are valued at cost.
3. The fair value of short-term debt approximates to the carrying value as the balance represents short-term loans and bank overdrafts.
4. The fair value of the long-term debt at the reporting date has been estimated at quoted market rates.
5. The fair values shown for short and long-term debt do not take account of the fair values of cross currency swaps shown above.

The movement in unrecognised gains and losses on instruments used for hedging is as follows:

	Gains £m	Losses £m	Total net gains/ (losses) £m
Unrecognised gains/(losses) on hedges at 31 December 2002	38	(7)	31
(Gains)/Losses on hedges arising in previous periods that were recognised during the year	(6)	4	(2)
Gains/(Losses) on hedges arising before 31 December 2002 that were not recognised during the year	32	(3)	29
Gains/(Losses) on hedges arising during 2003 that were not recognised during the year	19	(28)	(9)
Unrecognised gains/(losses) on hedges at 31 December 2003	**51**	**(31)**	**20**
Of which:			
Gains/(Losses) expected to be recognised in 2004	2	(13)	(11)
Gains/(Losses) expected to be recognised in 2005 or later	49	(18)	31

Short-term debtors and creditors are not included in these disclosures.

29 Commitments and contingent liabilities

a) At 31 December 2003, the Group had commitments contracted but not provided of £41 million (31 December 2002 £45 million) for capital expenditure.

b) The Group is aware of claims in respect of current and former employees, including former employees of the CEGB, and contractors in respect of industrial illness and injury and other potential claims which involve or may involve legal proceedings against the Group.

The directors are of the opinion, having regard to legal advice received, the Group's insurance arrangements and provisions held, as appropriate, that it is unlikely that the matters referred to above will have a material effect on the Group's financial position, results of operations or liquidity.

c) In 1990 and 1994, complaints were made to the European Commission by the National Association of Licensed Opencast Operators (NALOO) and the South Wales Small Mines Association (SWSMA) against the Company and National Power plc. The complaints alleged breaches of EU law by the Central Electricity Generating Board in its coal purchasing practices prior to 1990. Under the arrangements for electricity privatisation, it is possible that either or both of the Company and National Power plc (through its successor companies) could be liable to pay any compensation that may ultimately arise. The Commission rejected both complaints, on legal grounds, in 1998, which decisions were appealed by NALOO and some former members of SWSMA. In 2003, the Court of Justice of the European Communities found in favour of NALOO, overturning the Commission's rejection of the complaint. This is likely to influence the outcome of the appeal by the former SWSMA members, where judgment has not yet been given. Powergen has not been notified of any steps taken by the Commission following the Court's judgment. It is not practicable to estimate legal costs, or the risk or amount of possible compensation, at this stage.

d) The Group has in place a portfolio of fuel contracts of varying volume, duration and price, reflecting market conditions at the time of commitment. These contracts are with UK and international suppliers of coal and are backed by transport contracts for rail, road, canal and sea movements. At 31 December 2003 the Group's future commitments for the supply of coal under all its contractual arrangements totalled £53 million (31 December 2002 £313 million).

Following the acquisition of Edenderry (see note 10), the Group also has purchase contracts for peat to burn in that power station. At 31 December 2003 the Group's future purchase commitment totalled £17 million.

29 Commitments and contingent liabilities (continued)

The Group is also committed to purchase gas under various long term gas supply contracts including the supply of gas to the Group's three UK power stations. At 31 December 2003 the estimated minimum commitment for the supply of gas under all these contracts totalled £1,178 million (31 December 2002 £3,270 million).

The Group is also committed to power purchase contracts for the supply of electricity. At 31 December 2003 the total contractual commitment for the group was £978 million (31 December 2002 £1,021 million).

e) In the normal course of business the Group gives certain other indemnities and guarantees which are not considered to be material in the context of these financial statements and on which no losses are anticipated to arise.

30 Ultimate holding company

The immediate parent undertaking is Powergen Group Investments Limited. The ultimate parent undertaking and controlling party is E.ON AG, which is the parent company of the largest group to consolidate these financial statements. The smallest group to consolidate these financial statements is that of which Powergen Limited is the parent undertaking. Copies of E.ON AG's Annual Report are available from the offices of E.ON AG at the following address:

E.ON AG
E.ON-Platz 1
D-40479
Düsseldorf
Germany

31 Post balance sheet event

On 16 January 2004, EME Distribution No.2 Limited, a direct subsidiary of Powergen UK plc, acquired the issued share capital of Aquila Sterling Limited. The principal activity of that group is the Midlands Electricity distribution business which services the West Midlands and compliments the East Midlands distribution business already operated by Powergen.